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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. **451**

ANDREW W. COMSTOCK, a holder of Missouri Pacific Railroad Company 5 $\frac{1}{4}$ % Secured Serial Gold Bonds, on behalf of himself and others holding upward of \$900,000. principal amount of said bonds,

Petitioner,

vs.

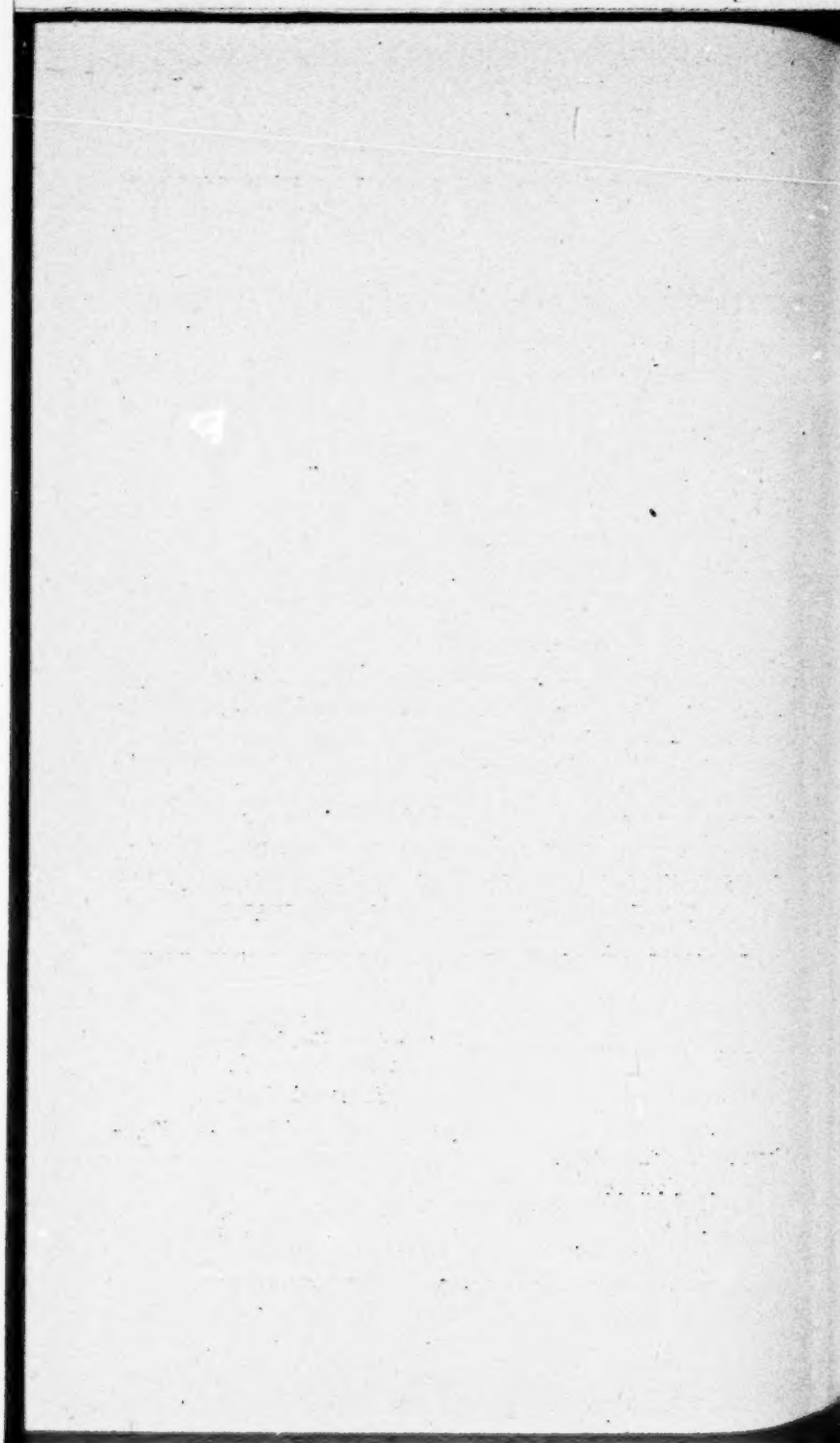
GROUP OF INSTITUTIONAL INVESTORS, holding First and Refunding Mortgage 5% Gold Bonds of Missouri Pacific Railroad Company, et al.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

WILLIAM H. BIGGS,
Attorney for Petitioner,
Security Building,
St. Louis 2, Missouri.

PHILLIP I. BLUMBERG,
of Counsel.



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ANDREW W. COMSTOCK, a holder of Missouri Pacific Railroad Company 5 $\frac{1}{4}$ % Secured Serial Gold Bonds, on behalf of himself and others holding upward of \$900,000. principal amount of said bonds,

Petitioner,

VS.

GROUP OF INSTITUTIONAL INVESTORS, holding First and Refunding Mortgage 5% Gold Bonds of Missouri Pacific Railroad Company, et al.,

Respondents.

PETITION FOR WRIT OF CERTIORARI

TO THE HONORABLE THE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner respectfully prays that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Eighth Circuit to review the order and judgment of that Court rendered in the above cause, affirming the order, judgment, and decree of the District Court of the United States for the Eastern District of Missouri.

Jurisdiction

Jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended. The date of the order and judgment of the Circuit Court of Appeals for the Eighth Circuit was August 28, 1947.

The Opinions of the Courts Below

The opinion of the District Court (R. 1089*) is reported in 64 F. Supp. 64. The opinion of the Circuit Court of Appeals for the Eighth Circuit (R. IV—13) is reported in 163 F. (2d) 350.

Summary Statement of the Case

This case involves the validity and priority of the \$10,565,227 claim of the Missouri Pacific R. R. Co. (hereinafter called MOP) in reorganization against its controlled and dominated subsidiary, New Orleans, Texas & Mexico Ry. Co. (hereinafter called NOTM). MOP seeks to insert its Inter-Company Claim ahead of the claims of public investors, secured by MOP's pledge of NOTM capital stock.

MOP managed the financial affairs of NOTM in the following manner. It caused NOTM to pay to it dividends over twenty consecutive quarters well in excess of NOTM income, although NOTM was without funds and was already borrowing for an extensive expansion program.

For three years, NOTM could only pay such dividends to MOP by bookkeeping transactions in which MOP made

* References to the transcript of the record are indicated by the letter "R." except for Volume IV thereof which is indicated by "R. IV". References to the volumes of exhibits are indicated by the letters "Ex.". Arabic numerals in all instances indicate pages.

"advances" to NOTM one day in amounts substantially equivalent to the dividends paid by NOTM on the next.

NOTM's lack of resources required it to borrow continually and heavily from the public, when it could, and from MOP, when public borrowing was impossible. MOP supplied NOTM with funds, but MOP always termed them "advances", and never additional capital investments.

MOP further sought to benefit itself at NOTM's expense by other methods, one of which was a bookkeeping shifting of indebtedness. MOP arbitrarily increased its claim against NOTM and as consideration therefor allegedly arranged for the assignment to NOTM of uncollectible claims in the same face amount, from which NOTM to this day has not received one penny.

These "advances" for dividends, these "advances" in lieu of needed capital investments, and this arbitrary shifting of indebtedness constitute practically the entire Inter-Company Claim allowed by the Courts below.

Petitioner contends that the Claim must be disallowed or subordinated.

Facts

This petition is submitted on behalf of Andrew W. Comstock, representing himself and fourteen other public investors owning in excess of \$980,000 principal amount of Missouri Pacific 5¼% Secured Bonds.* On the bankruptcy of MOP, \$12,140,000 of these bonds were outstanding, secured by MOP's pledge of 121,460 shares, or 82%, of NOTM capital stock.**

On March 31, 1933, MOP and NOTM filed petitions for reorganization under Section 77 of the National Bankruptcy Act (R. 89). On September 19, 1947, at the request

* Comstock's objections to the MOP Claim were also adopted by a committee representing an additional \$199,000 principal amount of such bonds.

** NOTM has only one class of stock.

of the Interstate Commerce Commission (hereinafter called Commission), the Plan of Reorganization of these roads was remanded to the Commission for "further investigation, consideration and recommendation". The Commission hearings on the Reorganization Plan are not scheduled to begin until January 27, 1948.

Review of this case will not delay the reorganization.

In these proceedings, MOP filed a proof of claim against NOTM in the amount of \$10,565,226.78, allegedly based on

"Cash advances for operation, interest payments and so forth, at various times from March, 1929 to February, 1933, both inclusive" (Ex. 1, R. 402).

The alleged creditor, MOP, and the alleged debtor, NOTM, at all times have had a common trustee, Mr. Guy A. Thompson.* This common trustee at no time took any steps to oppose the MOP Inter-Company Claim.

Public investors found it necessary to assume the burden of protecting NOTM against this alleged claim. Petitioner thus asserted objections to the MOP Claim in the 1943 Commission hearings on the MOP Plan. The Commission ruled that this issue "should be left to litigation in the courts" (R. 20842).

Petitioner objected to the MOP Claim in the District Court, contending, among other things, that the MOP Claim must be disallowed or subordinated to the claim of the MOP 5¼% Secured Bonds** (R. 227, 232-33, 237-47). After hearings, the District Court overruled such objections and allowed the MOP Claim in full, together with interest at 5½% and 6%, totalling an additional \$7,500,000. The Circuit Court of Appeals for the Eighth Circuit affirmed (R. 7, IV-13).

* Mr. L. W. Baldwin had originally been appointed a co-trustee of MOP and NOTM, but resigned in 1935 (R. 76, 89).

** The Commission assumed the validity and priority of the claim in determining the allocation to the MOP 5¼% Secured Bonds (R. 20842). Clearly if such claim is invalid or is subordinated, the treatment to be accorded such bonds in any subsequent plan must necessarily be materially enhanced.

There is remarkably little in the record which is disputed. Almost all the evidence is documentary, taken from the books and records of MOP, NOTM and its subsidiaries.

MOP Ownership of NOTM

Under circumstances condemned by the Commission,* MOP acquired majority control of NOTM from a banking syndicate in 1924.

Until bankruptcy, MOP thereafter dominated NOTM and NOTM's subsidiaries through ownership of up to 93% of NOTM stock, through common officers, and through interlocking directorates. Every director of NOTM was a MOP director or officer—MOP officers occupied comparable offices in NOTM and NOTM subsidiaries (Ex. 5-61, 177, R. 403-6, 630). NOTM was operated as a department or instrumentality of MOP.

Exploitation of NOTM by Wrongful Dividends

Under MOP control, NOTM was caused to pay dividends in each and every quarter from 1925 through 1931, aggregating \$7,267,386. Almost all these dividends went to MOP (Ex. 177, R. 630). Even though NOTM was then borrowing to pay its operating charges, interest due on its bonds, and sinking fund obligations, MOP's pressure on NOTM for dividends was unrelenting** (Ex. 281, R. 900).

* *Control of Gulf Coast Lines by Missouri Pacific R. R.*, 94 I. C. C. 191, 199-200, 204 (1924). NOTM and its subsidiaries (other than the International-Great Northern Ry. Co., hereinafter called I-GN) are known as the Gulf Coast Lines (R. 10).

** The Commission referring to MOP's dividend policy said: at a later date that MOP under Van Sweringen control: " * * * for its own purposes caused or permitted carrier corporations which it controlled to pay dividends when they were not being earned, or to pay dividends when they were under a heavy burden of debt, when traffic was declining, and earnings were decreasing notwithstanding scrimping of maintenance." *Chesapeake & Ohio Ry. Purchase*, 261 I. C. C. 239, 255 (1945).

**(a) NOTM Dividends to MOP Exceeded
NOTM Earnings**

NOTM dividends substantially exceeded income. In only two * of the seven years from 1925 through 1931 was NOTM's income adequate to pay the annual dividends exacted by MOP (Ex. 195, R. 663).

The total consolidated earnings of NOTM and its subsidiaries were less than NOTM dividends in each year from 1927 to bankruptcy. During this period, NOTM dividends totalled \$5,190,000 against consolidated earnings of \$1,151,000 (Ex. 301, R. 914).

NOTM dividends were not merely in excess of income. Mr. Wyer, the principal witness in support of the claim, admitted before the United States Senate Committee on Interstate Commerce that 1931 NOTM dividends were paid out of capital.**

**(b) Matching of Simultaneous MOP Advances
to NOTM and NOTM Dividends to MOP**

From 1928 through 1931, NOTM was able to pay dividends only by simultaneous advances from MOP (Ex. 281, R. 900). These MOP advances were paper transactions by which MOP advanced sums to NOTM with one hand, and simultaneously took them back by way of dividends with the other. They were usually accomplished by checks drawn by an officer of MOP and then endorsed by the same person acting as an officer of NOTM (Ex. 239, 26-50, R. 791, 406). Without such paper advances, NOTM could not have paid these dividends (Ex. 75-79, R. 453).

For example, on February 28, 1930, NOTM had a cash balance of only \$13,565. On that day, NOTM borrowed

* Without the paper dividends from a subsidiary which the Commission later condemned and directed NOTM to write off insofar as then still unpaid, NOTM suffered a substantial loss in 1931 although the books show an ostensible profit for the year (Ex. 62-4, R. 420-2).

** *Hearings before Subcommittee of Senate Committee on Interstate Commerce* pursuant to S. Res. 71, 75th Cong., 1st Sess., Part 12, p. 5296 (1938). Judicial notice may be taken of these official reports. *Arizona v. California*, 283 U. S. 423, 453-4 (1931).

\$260,000 from MOP. On the next day, NOTM paid its quarterly dividend of \$259,576, of which \$242,072 went back to MOP.

This matching of simultaneous advances from MOP and dividends to MOP was repeated in eleven out of thirteen consecutive quarters, from November, 1928 through November, 1931 (Ex. 75-81, 281, R. 453, 900).

<i>Amount of MOP "Advance"</i>	<i>Date of MOP "Advance"</i>	<i>Payment of NOTM Dividend</i>
\$ 300,000	Nov. 30, 1928	1 day later
250,000	Feb. 28, 1929	1 day "
275,000	Aug. 31, 1929	3 days "
310,000	Nov. 29, 1929	2 days "
260,000	Feb. 28, 1930	1 day "
275,000	May 31, 1930	1 day "
300,000	Nov. 29, 1930	2 days "
75,000	Feb. 25, 1931	3 days "
200,000	May 27, 1931	5 days "
250,000	Aug. 29, 1931	2 days "
300,000	Nov. 27, 1931	4 days "
\$2,795,000	TOTAL "ADVANCES"	TOTAL DIVIDENDS* \$2,855,333
		MOP's Share \$2,654,000
\$ 254,091	AVERAGE "ADVANCE"	EACH DIVIDEND \$ 259,576

Although MOP advanced to NOTM \$2,795,000, it received back \$2,654,000 in dividends within a day or two. The total net advance from MOP to NOTM was only \$141,000 (\$2,795,000 less \$2,654,000) (Ex. 177, R. 630).

Yet, the Courts below allowed MOP its claim of \$2,795,000 plus interest of about \$2,000,000, aggregating about \$4,795,000, for this net advance of \$141,000. This constitutes a return of over 3400% to a fiduciary parent.

**(c) Dividends Drained from Brownsville to Make
Possible NOTM Dividends to MOP**

In order to make possible the steady flow of NOTM dividends to MOP, the St. Louis, Brownsville & Mexico Ry.

* Eleven dividends of \$259,575.75 each.

Co. (hereinafter called Brownsville)—NOTM's principal subsidiary—was repeatedly caused to declare dividends to NOTM (Ex. 111-21, 123-34, 172, 206, R. 569-601, 616, 674). This policy reached a fantastic climax in 1931.

On April 16, 1931, Mr. Baldwin—President of MOP and NOTM—wrote to Mr. Safford—Vice-President of MOP and NOTM:

"I want to impress upon you again the fact that although it may necessitate a much more drastic curtailment of expense than you have ever had or anticipated, the NOT&M must earn and pay its dividend this year and have \$100,000 left in addition" (Ex. 135, R. 601).

Mr. Safford replied that NOTM earnings were much too low to make this possible despite the fact that expenses were "very close to the irreducible minimum unless we make some further drastic reduction in service" (Ex. 135-7, R. 601). Nonetheless, MOP caused NOTM to pay its dividends regularly in 1931 although "earnings were decreasing notwithstanding scrimping of maintenance" (261 I. C. C. at 255). NOTM was able to do so only as a result of an ostensible surplus created by 1931 Brownsville dividends.

On June 17, 1931, MOP caused Brownsville to declare dividends to NOTM of \$655,079 or 131% on Brownsville stock (Ex. 113-9, 206, R. 576, 579, 674). This was still not enough. On July 11, 1931, Brownsville, at MOP's direction, declared a further dividend of 700% amounting to \$3,500,000, an amount greater than the sum of all Brownsville dividends for the preceding fifteen years (Ex. 106, 206, R. 564, 674).

These 1931 dividends totalled \$4,155,079, although Brownsville suffered a deficit for the year (Ex. 309, R. 927). These dividends have not been paid in full even to this date (Ex. 102, R. 519).

In auditing the Brownsville accounts, the Commission held that the interlocking directors and officers knew at

the time that these Brownsville dividends could not be paid. Accordingly, the Commission disapproved the dividends and directed NOTM to write them off insofar as they were then still unpaid (Ex. 62-4, R. 420-2).

These 1931 and earlier Brownsville dividends were declared though Brownsville's long past due indebtedness to NOTM for fuel, materials and supplies, and even for interest paid on Brownsville equipment trust notes, had been steadily mounting from less than one million dollars in 1924 to over \$10,200,000 by 1932 (Ex. 102, 103, 189, R. 519, 538, 660).

In such fashion, MOP—by reason of its own desperate position—disregarded the needs and welfare of NOTM and its subsidiaries (Ex. 83, 156-60, R. 455, 613). The fiscal affairs of NOTM were managed in the New York or Cleveland offices of MOP—without regard to the railroad operations of NOTM* (R. 590, 594, 597). In short, every financial act of NOTM was the act of MOP. Beyond that, MOP determined the form in which such financial transactions were recorded on the books of MOP and NOTM.

MOP's Claim Includes \$1,261,009 Saddled on NOTM without Authority or Consideration

In October, 1932, MOP imposed a bookkeeping transaction on NOTM amounting to \$1,261,009 which MOP included in its claim and which the Courts below allowed (Ex. 221-5, 231-2, 240-1, R. 701, 706, 794).

This transaction was conducted in the shadow of bankruptcy, which occurred less than six months later.

* Mr. Baldwin, President and operating head of MOP and NOTM, testified that his relations with the financial offices in New York were: "**** quite indefinite, largely being a good fellow, I guess ****" (R. 597). The Chairman of the Board and Mr. Wyer had their offices in New York and then in Cleveland.

The only contact that the NOTM main office in Houston, Texas had with the NOTM financial office in New York and Cleveland was through the MOP office at St. Louis. The NOTM auditing department never saw the books kept in the NOTM financial office. That was under the "jurisdiction" of the MOP office (R. 499-502, 590-5).

MOP had unsecured claims against two subsidiaries—NOTM and I-GN. The financial position of NOTM was stronger (R. 20879, Appdx. C).

MOP moved to improve its position by shifting debtors. MOP arbitrarily increased its claim against NOTM by \$1,261,009. MOP simultaneously reduced its claim against I-GN by the same amount. As alleged consideration for the write-up, MOP planned to have I-GN assign to NOTM \$1,261,009 of uncollectible claims which I-GN had against certain NOTM subsidiaries—I-GN sister companies. NOTM had not previously had any connection with or liability for these claims in any way.

There was no pretense of corporate action by NOTM or I-GN. Mr. Wyer in Cleveland merely wrote a directive on MOP stationery to Mr. Baldwin outlining what was to be done, and the bookkeeping entries followed automatically (R. 703).*

The officers of MOP knew at the time that these I-GN receivables were uncollectible (R. 797, 1043; Ex. 240, R. 794).**

Mr. Eckert, the then NOTM auditor and one of the few NOTM officers who was not also an officer of MOP, did not know the details of this transaction until the District Court hearing, twelve years later (Ex. 52, R. 406). Mr. Eckert testified:

“ * * * I haven't seen any of these (journal) entries at all. This is news to me” (R. 702).

* This is one example of Mr. Wyer's bookkeeping. Before the Senate Committee, Mr. Wyer admitted that his bookkeeping of MOP and MOP subsidiaries had been false in numerous respects.

President (then Senator) Truman, who was conducting the hearing, replied to a comment by Mr. Wyer: “Mr. Wyer * * * this statement is exactly in line with your bookkeeping. I do not think it conveys the truth * * *” (Senate Committee Hearings, *supra*, 75th Cong., 1st Sess., Part 12, pp. 5059-63, 5079, 5269).

** For example, about \$800,000 of these claims were due from a road, San Antonio, Uvalde & Gulf R. R., that had been in default for years on its first mortgage bond interest, which default totaled \$975,000 by December 31, 1932 (Ex. 179, 223, R. 632, 701).

Yet, the sum of \$1,261,009, together with interest amounting to about \$900,000, was allowed by the Courts below.

The record contains evidence of other examples of financial burdens imposed on NOTM by MOP for the benefit of MOP. Thus, NOTM was compelled to borrow and expend millions of dollars to acquire North Texas "feeder" lines for the benefit of MOP and I-GN, not NOTM (Ex. 193, 233, R. 662). These "feeder" roads* do not even connect with NOTM or any of the Gulf Coast Lines, but tie in with I-GN (Ex. 213, R. 605-6, 678). As the Commission found, it was recognized that these "feeder" lines "were really acquired for the benefit of the entire (MOP) system . . . they have usually been operated at a deficit since acquisition." **

Respondents in the Courts below presented testimony in an effort to show that the traffic, physical conditions and operations of NOTM had been improved during the years of MOP control (R. 814-67, 933-59; Ex. 249-66). The District Court so found (R. 13).

History of NOTM Notes Representing the Bulk of the Claim

All MOP "advances" to NOTM—whether cash, book-keeping entries or paper transactions—were recorded as open book accounts. When MOP sought to obtain loans from the Reconstruction Finance Corporation and the Railroad Credit Corporation (hereinafter called R. F. C. and R. C. C.), the open accounts constituting the MOP Claim (except for \$610,000) were transmuted into two demand notes within nine weeks of bankruptcy. These notes were signed by Mr. William Wyer, as Treasurer of NOTM,

* These include the Asphalt Belt Ry., Asherton & Gulf Ry., and the San Antonio Southern Ry.

** *Missouri Pacific R. R. Reorganization*, 239 I. C. C. 7, 71 (1940).

and delivered to himself as Treasurer of MOP (Ex. 51-2, 348-9; R. 406). The notes were immediately pledged together with other collateral by MOP to the R. F. C. and R. C. C. (R. 30).*

Subsequently, pursuant to Court order, the R. F. C. and R. C. C. claims against MOP were paid and the claims and collateral, including the two NOTM notes, surrendered to the Trustee of MOP (R. 1155, 1164). The R. F. C. was then stricken as a party to these proceedings (R. 1348).

Nature of the Proceedings Below

In the District Court, petitioner Comstock originally petitioned for leave to file objections to the MOP Claim in the name of the Trustee of NOTM (R. 247). He also filed objections to the then pending MOP Plan; of these, objection No. 19 and related objections repeated the objections to the MOP Claim contained in the first petition (R. 227, 232-33).

Counsel for respondents contended that the issues raised by these two documents of petitioner were identical, and that petitioner should be compelled to litigate the Claim in connection with the hearings on the Plan, rather than in two separate hearings (R. 338-39, 365-67). The District Court agreed (R. 367).

The validity and priority of the MOP Claim, as attacked in Comstock's Objection No. 19, were thereafter the subject of a separate hearing by the District Court, and were determined by a separate order, from which a separate appeal to the Circuit Court of Appeals was taken (R. 1, 7, 378).

* An R. F. C. official stated that the R. F. C. made the loans to MOP on the basis of financial statements sworn to by Mr. Wyer which were false and "crooked" (Senate Committee Hearings, *supra*, 75th Cong., 1st Sess., Part 3, pp. 1116, 1139 [1938]). The late Commissioner Joseph B. Eastman also characterized these financial statements as false (Senate Committee Hearings, *supra*, 74th Cong., 2d Sess., Part 2, p. 544 [1938]). The Commission deemed this incident sufficiently serious to be included in its formal report to the Congress, (1937) I. C. C. Annual Report, pp. 27-8.

The District Court held that the MOP Claim "should be allowed" (R. 31-4). The Circuit Court held that "the claim of Missouri Pacific was properly allowed" (IV—27).

The Courts below were thus passing on the validity and priority of a claim and objections thereto.*

This is litigation over such orders of allowance and is independent of any particular plan of reorganization.

The Questions Presented

1. Whether the \$10,565,227 claim of a parent corporation in reorganization against a dominated subsidiary is valid in its entirety and ranks prior to the claim of public investors, who are secured by the parent's pledge of the subsidiary's stock, when:

(a) \$2,795,000 of the Claim is based on eleven "advances" made by the parent over thirteen consecutive quarters which were matched within one to five days by dividends from the subsidiary to the parent in substantially equivalent amounts, which the subsidiary could not have otherwise paid.

(b) The parent did not permit the subsidiary to devote its earnings to its own needs, but caused the subsidiary to pay to the parent twenty consecutive quarterly dividends in excess of earnings, and four and one-half times the consolidated earnings of the subsidiary and its affiliated companies, while the subsidiary was already borrowing heavily for an extensive expansion program.

(c) \$1,261,009 of the Claim is based on the parent's write-up of the subsidiary's indebtedness through book-keeping entries made six months before bankruptcy without the consent or approval of the subsidiary—the consideration for such write-up being the alleged assignment to the subsidiary of uncollectible claims in the same face

* There were three other related appeals heard before the Circuit Court on a consolidated record. These three causes are the subject of the petition annexed hereto.

amount, from which the subsidiary has not received one penny to this day.

(d) Much of the Claim represents funds supplied by the parent to the subsidiary, whose resources were inadequate to enable it to finance an extensive expansion program, after public borrowing became impossible, which funds were denominated by the parent as "advances" and never as additional capital investments.

2. Whether the doctrine of subordination of a claim of a parent corporation against a dominated subsidiary to the claims of public investors is inapplicable, when the parent corporation is insolvent and its claim is asserted by the parent's creditors, who did not participate in the parent's wrongdoing?

3. Whether the doctrine of subordination of a claim of a parent corporation against a dominated subsidiary to the claims of public investors is inapplicable, when such public investors are claiming through the *common* stock of the subsidiary?

4. Whether a court may allow the disputed claim of a parent corporation against a dominated subsidiary, both being in reorganization with the identical trustee, over the challenge of public investors, when the subsidiary has never had the protection of a separate and independent trustee?

Reasons Relied On for the Allowance of the Writ

1. The decision of the Circuit Court of Appeals for the Eighth Circuit is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit on the same matters. *In re Commonwealth Light & Power Co.*, 141 F. (2d) 734 (C. C. A. 7th, 1944).

2. The decision of the Circuit Court of Appeals for the Eighth Circuit is in conflict with the decision of this Court in *Taylor v. Standard Gas & Electric Co.*, 306 U. S. 307 (1939), on the same matters.

3. It is of public importance in the administration of the bankruptcy laws and of large corporate reorganizations thereunder that certain questions relating to the scope of the doctrine of subordination be settled. These questions presented by the instant case are:

(a) Whether the claim of a parent corporation against a dominated subsidiary may be subordinated to the claims of public investors, when the parent corporation is insolvent and its claim is asserted by the parent's creditors, who did not participate in the parent's wrongdoing?

(b) Whether the claim of a parent corporation against a dominated subsidiary may be subordinated to the claims of public investors, when such public investors are claiming through the *common* stock of the subsidiary?

4. The decision of the Circuit Court of Appeals for the Eighth Circuit is in conflict with the established policy of the Securities and Exchange Commission.

5. The Circuit Court of Appeals for the Eighth Circuit has decided a question of law of substantial importance in the administration of the bankruptcy laws, which has not been settled, but which should be settled by this Court, to wit,

a disputed claim of a parent corporation against a dominated subsidiary, both being in reorganization with the identical trustee, may be allowed over the challenge of public investors although the subsidiary has never had the protection of a separate and independent trustee.

CONCLUSION

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued under the seal of this Court, directed to the United States Circuit Court of Appeals for the Eighth Circuit to review the order and judgment of that Court in the above cause; and that said order and judgment be reversed; and that your petitioner be granted such other and further relief as may seem proper.

Respectfully submitted,

WILLIAM H. BIGGS,
Attorney for Petitioner,
Security Building,
St. Louis 2, Missouri.

PHILLIP I. BLUMBERG,
of Counsel.

IN THE
Supreme Court of the United States

OCTOBER TERM, 1947

No.

ANDREW W. COMSTOCK, a holder of Missouri Pacific Railroad Company 5 $\frac{1}{4}$ % Secured Serial Gold Bonds, on behalf of himself and others holding upward of \$900,000. principal amount of said bonds,

Petitioner,

vs.

GROUP OF INSTITUTIONAL INVESTORS, holding First and Refunding Mortgage 5% Gold Bonds of Missouri Pacific Railroad Company, et al.,

Respondents.

**BRIEF IN SUPPORT OF PETITION FOR
WRIT OF CERTIORARI**

The matters set forth in the foregoing petition are hereby adopted and made part of this brief.

POINT I

The instant case is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in the *Commonwealth* case.

The decision of the Circuit Court of Appeals for the Eighth Circuit in the instant case is in square conflict with

the decision of the Circuit Court of Appeals for the Seventh Circuit in *In re Commonwealth Light & Power Co.*, 141 F. (2d) 734 (C. C. A. 7th, 1944).

In the *Commonwealth* case, the parent corporation, Inland, organized a subsidiary, Michigan, and received all the Michigan common stock. Inland then pledged this stock to secure a public issue of Inland bonds.

Years later, Inland (the parent) went into Section 77B reorganization proceedings. It then had a \$620,132 claim against Michigan for advances.

Michigan never went into reorganization, and its stock was subsequently sold for over \$1,000,000, pursuant to court order.* The question was whether the proceeds of the sale should first be applied to Inland's \$620,132 claim against Michigan, or to the claim of Inland public bondholders who had held the pledged Michigan common stock.

The Circuit Court of Appeals subordinated the parent's claim and awarded the proceeds to the public investors, concluding that:

"Michigan was under the complete control and domination of Inland; that

it was insufficiently capitalized; that

Inland failed to make provision for sound financing for Michigan's extensive rehabilitation and expansion program; and that

Michigan, upon the demand of Inland, declared dividends which were paid to Inland by open account borrowings from Inland. * * * " (141 F. (2d) at 739).

The basic identity between the *Commonwealth* case and the instant case cannot be questioned. Every element emphasized by the Court in the *Commonwealth* case is present herein.

* To facilitate the sale, the Michigan stock was sold free of the Inland claim.

(a) Complete Control and Domination

Like Inland, MOP completely dominated and controlled its subsidiary, NOTM. Respondents herein have conceded such control (Institutional Group Brief, C. C. A. 8th, March 29, 1947, p. 53). The Courts below so found (R. 11; IV—15).

(b) Matching "Advances" and Dividends

MOP and Inland both insisted on a continued flow of dividends from their subsidiaries irrespective of earnings, financial needs, or even the utter lack of funds with which to pay dividends.

Quarter in and quarter out in 1929, 1930 and 1931, the parents thus made "advances" to their respective subsidiaries on one day which were matched by "dividends" to the parents in relatively equivalent amounts a few days later.

In the *Commonwealth* case, this bookkeeping matching occurred as follows:

<i>Amount of Advance</i>	<i>Date of Advance</i>	<i>Payment of Dividend</i>	<i>Amount of Dividend</i>
\$29,576	June 25, 1929	5 days later	\$29,576
29,576	Sept. 26, 1929	4 days later	29,576
60,000	Jan. 6, 1930	6 days before	51,844
8,000	June 25, 1930	5 days later	7,663
40,000	Oct. 9, 1930	9 days before	38,313
59,000	Mar. 25, 1931	6 days later	34,000
40,000	June 20, 1931	10 days later	34,000
45,000	Sept. 24, 1931	5 days later	34,000
25,000	Dec. 26, 1931	5 days later	34,000
82,500*	Mar. 30, 1932	1 day later	34,000

(S. E. C. Ex. 28, *Commonwealth* Record, C. C. A. 7th, Vol. II, pp. 985-7)

On page 7, *supra*, appears a chart of almost simultaneous MOP advances and NOTM dividends in relatively equivalent amounts. Language cannot state more emphatically than these two charts the identity between the *Commonwealth* case and the instant case.

* This item bears a notation also referring to bond interest.

The Circuit Court below did not even refer to the *Commonwealth* case, although petitioner emphasized its identity with the case at bar.

It is indisputable that if MOP or Inland had not made these advances, payment of the dividends would have been impossible. NOTM and Michigan did not have the funds (Ex. 75-79, R. 453; S. E. C. Ex. 28, *Commonwealth* Record, C. C. A. 7th, Vol. II, p. 986).

(c) Absence of Sound Financing for Expansion

The Court in the *Commonwealth* case also emphasized Inland's role in failing to provide sound financing for the "extensive rehabilitation and expansion program" which it caused Michigan to undertake.

By supplying Michigan with funds needed for improvements in the form of loans rather than as additional equity investment, Inland created a claim, which it later sought to insert ahead of the claims of public investors.

MOP's financing of NOTM's expansion program was even more harmful.

Whereas in the *Commonwealth* case, Inland kept Michigan dividends to 80% of Michigan earnings, MOP went further. It compelled NOTM to declare dividends well in excess of earnings. Thus, from 1927 to 1932, NOTM dividends were four and one-half times consolidated NOTM earnings. Dividends of \$5,190,000 were paid against earnings of only \$1,151,000 (Ex. 301, R. 914).

Furthermore, Inland made an additional capital contribution to Michigan by surrendering its claim for \$450,000 of previous advances for additional Michigan common stock; this sum was almost three-quarters of Inland's subsequent claim.

MOP, however, compelled NOTM to finance its expansion program entirely out of borrowed funds. When MOP acquired a controlling interest in NOTM from the bankers,

it did not put a penny into the NOTM treasury. On the contrary, to reduce the purchase price to MOP, NOTM was caused to pay \$2,500,000 in extraordinary dividends.

Nor did MOP subsequently make any additional equity investment in NOTM.*

MOP's draining of the NOTM treasury did not stop there. By compelling NOTM to pay dividends well in excess of earnings, MOP actually decreased its investment in NOTM and prejudiced the equity of the pledged stock.

Such a drain on NOTM assets for the benefit of MOP substantially weakened NOTM's ability to finance, out of its own assets, the expansion program thereafter dictated by MOP. NOTM became all the more dependent on borrowing from MOP.

(d) Inadequate Capitalization

The resources of Michigan were inadequate for the conduct of its business. Its financial history, like that of NOTM, consisted of a dreary cycle of bank loans and advances from its parent (Inland) which in turn were refunded as long as possible by public security issues. Despite Michigan's needs, Inland did not want its own funds tied up in Michigan, and repaid itself as fast as it could with the proceeds of Michigan public security issues.

Michigan's publicly held bonds and preferred stock increased by 250% in five years. Michigan's cash position was weak and its open account indebtedness to Inland continued to grow. During the same period Inland made only one additional equity investment in Michigan.

Under MOP control, NOTM also suffered from insufficient capitalization. During the entire period, NOTM was forced to borrow continuously and heavily, in good years and in bad. It borrowed, among other things, for an improvement program, for interest payments on bonded debt, for principal and interest on equipment trusts, and for sinking fund installments (Ex. 281, R. 900).

* Its shares of NOTM stock were acquired from New York bankers or on the market; NOTM received no additional capital.

As long as possible, these sums were raised from the banks and MOP and refunded by public bond issues, with NOTM total bonded indebtedness climbing from \$29,382,600 in 1924 to almost \$43,000,000 four years later (Ex. 71, R. 432). Annual fixed interest requirements almost doubled, rising from \$1,463,000 in 1925 to \$2,685,000 in 1932 (Ex. 99, R. 488). At the same time, NOTM consolidated income declined precipitously (Ex. 301, R. 914).

After the spring of 1928, NOTM was no longer able to borrow from the public (R. 1024). At the same time, NOTM became chronically short of cash working capital.* From then until bankruptcy, NOTM's cash position grew weaker. Its open account debt to MOP rose steadily.

The *Commonwealth* case condemned the parent for the subsidiary's inadequate capitalization despite the fact that the subsidiary never went into reorganization. The inadequacy of capitalization in the instant case is all the more serious because it resulted in the subsidiary going into reorganization.

(c) **Public Pledges of the Subsidiary's
Stock Competing with the Insolvent
Parent's Creditors**

In each of these cases, the interest of the public investors arose in the same way. Public bondholders of the parent, secured by the parent's pledge of the subsidiary's capital stock, urged the subordination of the parent's claim.

Furthermore, each parent corporation was bankrupt. Creditors of the parent, who did not participate in the wrongdoing, asserted the parent's claim.

The *Commonwealth* Court expressly held that the fact that the parent's claim was not asserted by the parent itself did not prevent subordination to the claim of public in-

* NOTM cash which had averaged \$992,000 during the early years of MOP control (1925 to 1927) dropped sharply to an average of \$209,000 from 1929 to 1932 (Ex. 69, R. 432). These are year-end averages.

vestors. The District Court below, however, flatly disagreed, and held that subordination is inapplicable in such a situation (R. 1111). The Circuit Court below affirmed.

(f) Operational Benefits Do Not Excuse Financial Mismanagement

In each case, the parent's wrongdoing consists solely of financial exploitation.

In the *Commonwealth* case, Michigan had received substantial benefits from an "extensive rehabilitation and expansion program". Although this fact was vigorously urged in support of the claim,* the *Commonwealth* Court held that financial mismanagement by a parent required subordination.

The Courts below rejected subordination because of the operational benefits received by the subsidiary, NOTM. In so doing, they rejected the rule of the *Commonwealth* case (R. 1110, IV—26).

Thus, there is a fundamental identity between these two cases. The inter-corporate manipulations of the Insull Utility Empire are repeated, with surprising duplication of detail, in its contemporary, the Van Sweringen Railroad Empire.

In these very reorganization proceedings, the late Circuit Judge Faris excoriated the exploitation of MOP by its parent, the Van Sweringen-dominated Alleghany Corporation **; he stated:

"For to me it is plain that the Congress intended to stop a practice among railroads and their exploiters

* See Joint Brief of The Middle West Corporation and Bachrach, Trustee, in support of the Inland Claim, C. C. A. 7th, p. 27.

** This arose on the application of the R. F. C.—then a claimant—to require the MOP Trustee to disavow or rescind what Judge Faris subsequently found to be "improvident, unfair, unlawful and over-reaching" contracts imposed on MOP by Alleghany.

The R. F. C. application and the brief submitted by Mr. Justice Reed (then R. F. C. general counsel) attacked both Alleghany and Mr. Wyer's testimony in support of such contracts (R. F. C. Brief before Special Master, pp. 60, 77-8).

and manipulators which has had much to do with making the financial history of railroads the most indecent and sordid chapter ever written in this or any other nation." *In re Missouri Pacific R. R.*, 13 F. Supp. 888, 892 (D. Mo., 1935).

Upon identical patterns of inter-company financial wrongdoing, the Circuit Court of Appeals for the Eighth Circuit reached a decision contrary to that of the Circuit Court of Appeals for the Seventh Circuit.

We submit that this Court should resolve this conflict.

POINT II

The instant case is in conflict with the decision of this Court in the *Deep Rock* case.

The decision of the Circuit Court of Appeals for the Eighth Circuit is in conflict with the decision in the *Deep Rock* case, *Taylor v. Standard Gas & Electric Co.*, 306 U. S. 307 (1939).

In the *Deep Rock* case, this Court subordinated the entire claim of a parent, against a dominated subsidiary to the claim of public investors.

Both the parent, Standard, and the subsidiary, Deep Rock, had gone into Section 77B proceedings.

Standard asserted a claim against Deep Rock for advances totalling \$9,300,000. This claim was resisted by the independent trustee of Deep Rock. After prolonged hearings, Standard proposed a compromise reducing its claim to \$5,000,000, consisting solely of advances for the undisputed benefit of Deep Rock.

After rejecting one Plan based on this compromise, the District Court, with the support of most public Deep Rock preferred stockholders and the Deep Rock Trustee, allocated most of the new Deep Rock common stock to Standard for its \$5,000,000 compromise claim, and a small portion of new common to the public preferred stockholders for their \$5,000,000 claim. The Circuit Court affirmed.

This Court reversed, holding that it had been an abuse of discretion to fail to subordinate the entire Standard claim to the claim of the public preferred stockholders. The Court concluded:

"It is impossible to recast Deep Rock's history and experience so as even to approximate . . . its financial condition . . . had it been adequately capitalized and independently managed and had its fiscal affairs been conducted with an eye single to its own interests" (306 U. S. at 323).

(a) Domination and Control

Standard had controlled and dominated Deep Rock through 98% common stock ownership.

This Court emphasized that Standard and Deep Rock had common officers and that "all of the fiscal affairs of the debtor (Deep Rock) were wholly controlled by Standard which was its banker and its only source of financial aid" (306 U. S. at 311).

As we have seen, identical domination, control and financial dependence are present in the instant case.

(b) Dividend Policy

An outstanding instance of Standard's misconduct * was the exploitation of Deep Rock by continued insistence upon dividends. Out of Deep Rock earnings of about \$10,000,000, Standard compelled the declaration of over \$5,500,000 in dividends (*Deep Rock Record*, Supreme Court, Vol. II, pp. 649-50). Most of these dividends could only be paid by simultaneous borrowing from Standard.

This Court stressed that:

" . . . dividends were declared in the face of the fact that Deep Rock had not the cash available to pay them and was at the time borrowing in large amounts from . . . Standard . . .

* Other instances of Standard's abuse of Deep Rock included unfair leases, large service fees, 7% interest on open accounts compounded monthly, and the concealment of whether properties were being bought for Standard or Deep Rock.

"Whatever may be the fact as to the legality of such dividends . . . it is evident that they would not have been paid over the long course of years by a company on the precipice of bankruptcy and in dire need of cash working capital" (306 U. S. at 317, 323).

MOP's exploitation of NOTM through its dividend policy followed a similar line, and in some aspects was even more flagrant. Whereas Standard had kept Deep Rock dividends to less than 60% of earnings, NOTM dividends exceeded earnings.

Moreover, in the *Deep Rock* case, over half of Deep Rock dividends had gone not to Standard, but to the public preferred stockholders, the very class seeking subordination. MOP, however, received approximately 90% of each dividend it caused NOTM to declare.

(c) Inadequate Capitalization

Another element of financial mismanagement was Standard's policy of running Deep Rock without resources adequate for the conduct of its business. Such inadequacy of capitalization compelled the continued advances from the parent that mark both the *Deep Rock* case and the case at bar.

Although its original financing had enabled Deep Rock to acquire the properties needed for its business and provided \$6,700,000 in working capital, Deep Rock was soon forced to borrow, and its open account to Standard rose steadily.

As this Court stated:

" . . . So inadequate was Deep Rock's capitalization that, in the period from organization to 1926, the balance due on open account to Standard grew to more than \$14,800,000" (306 U. S. at 315).

Like Deep Rock, NOTM was able to conduct its business only by the continual infusion of funds borrowed from its parent.

Standard made additional equity investments in Deep Rock. Standard, for example, took additional Deep Rock common stock as payment for \$11,000,000 of previous advances. This sum was more than twice the amount of Standard's subsequent compromise claim.

In contrast, MOP did not make one penny additional equity investment in NOTM, and in effect, decreased its investment in NOTM by siphoning off dividends in excess of earnings.

The Court below was influenced by the operational benefits received by NOTM from MOP, and attempted to distinguish the *Deep Rock* case on this ground. We submit that the Court below was in error as a matter of law.

Operational benefits did not prevent subordination of the Standard claim. There was evidence of considerable physical improvement of Deep Rock.* This Court pointed out that Standard had acquired additional oil properties and erected additions for the benefit of Deep Rock (306 U. S. at 317, 319).

NOTM operational benefits were not dependent on MOP financial mismanagement. If advances for dividends had not been made or if NOTM indebtedness had not been arbitrarily written up, the MOP Claim would have been smaller. Yet, not one rail less would have been laid nor one trestle less constructed.

MOP's obligations as a fiduciary relate to each and every transaction with NOTM. Operational benefits cannot excuse any breach of fiduciary obligations.

The decision of the Court below seriously limits the protection extended to public investors by the *Deep Rock* case. It is submitted that this Court should prevent the *Deep Rock* doctrine from being whittled away.

* The *Deep Rock* record discloses that in 1927 alone, Deep Rock improvement and additions amounted to more than \$2,700,000, and in 1928 alone to more than \$1,700,000 (Vol. III, pp. 106, 108; Trustees' Exs. H, I).

POINT III

The instant case involves important questions as to the scope of the doctrine of subordination.

The decision of this Court in the *Deep Rock* case has engendered lively discussions in the law reviews on important questions as to the scope of the doctrine of subordination which are involved in the instant case.

E.g., Isaacs, *The Implications and Limitations of the Deep Rock Doctrine*, (1942) 42 Col. L. Rev. 376, 386-9;

Krottinger, *The "Deep Rock" Doctrine: A Realistic Approach to Parent-Subsidiary Law*, (1942) 42 Col. L. Rev. 1124, 1133, 1138-44;

Note (1941) 54 Harv. L. Rev. 1045, 1050-1.

The most important of these questions is whether the *Deep Rock* rule is inapplicable when the parent corporation is bankrupt and the struggle for priority is between creditors of the parent, who did not participate in the parent's wrongdoing, and innocent public investors with an interest in the subsidiary.

The *Commonwealth* case held that whether or not the parent is bankrupt is immaterial on the issue of priority. However, the District Court in the instant case, affirmed by the Circuit Court of Appeals for the Eighth Circuit, flatly disagreed with the Circuit Court of Appeals for the Seventh Circuit on the issue.

Furthermore, the District Court below held that this issue had not been involved in the *Deep Rock* case, and concluded that the doctrine of subordination was inapplicable. Although it seems to us that the *Deep Rock* case did settle the question, the commentators, cited above, view the question as still open for decision by this Court.

The *Deep-Rock* decision required subordination of a parent's claim in favor of public *preferred* stockholders. This Court has never passed upon the question whether subordination may be decreed in favor of public investors claiming through *common* stock of the subsidiary.

This open question, which has been the subject of extended discussion by commentators, is presented by the instant case.

POINT IV

The instant case is in conflict with the established policy of the Securities and Exchange Commission.

The decision in the instant case is in conflict with the established policy of the Securities and Exchange Commission (hereinafter called S. E. C.).

In the *Commonwealth* case, itself, the S. E. C. took a leading role in the litigation and insisted on complete subordination of the parent's claim.

In its recent decision in the *Indiana Service* case, the S. E. C. again attacked a claim of a parent for loans to a dominated subsidiary, which were matched by almost simultaneous dividends to the parent. The S. E. C. stated in language strikingly applicable to the case at bar:

"While some of the loans made by Utilities (the parent) to Indiana Service were more or less contemporaneous with the preferred and common stock dividend payment dates, Utilities states that there is no evidence that such advances were made in whole or in part for dividend purposes.

" . . . We think it is fairly obvious that the loans made to Indiana Service concurrently with the payment of common stock dividends to Utilities when Indiana Service was in need of funds for other purposes were for the purpose of converting earned surplus to notes payable. On the basis of the foregoing, we would have no difficulty in finding a proper basis for

subordination. . . . " (In re *Indiana Service Corporation*, S. E. C. Holding Company Act Release No. 7054, December 14, 1946, pp. 33-4).

So too, in the instant case MOP's matching of "advances" to NOTM concurrently with the payment of NOTM dividends to MOP was designed to convert "earned surplus" to "notes payable".

Despite the decisions in the *Deep Rock* case, the *Commonwealth* case, and the clearly articulated position of the S. E. C., the Circuit Court of Appeals for the Eighth Circuit refused to subordinate the MOP Claim. Such a conclusion, if uncorrected, will result in a serious encroachment on the protection which the above decisions extend to public investors.

POINT V

MOP's Claim against NOTM may not be allowed until NOTM has been given the protection of an independent Trustee.

MOP and NOTM have a common Trustee, Mr. Guy A. Thompson. This Trustee patently has conflicting loyalties. The performance of his duties as Trustee of MOP in pressing the MOP Claim inescapably clashes with his statutory duty as Trustee of NOTM to resist the Claim (Sec. 47a(8), National Bankruptcy Act). This conflict of interest has deprived NOTM of the full protection to which it is entitled by law, just as much as if it arose from opposing personal financial interests.

Whether the MOP Claim may be held to be valid and prior under such circumstances is a question of substantial importance in the administration of the bankruptcy laws, which should be settled by this Court.

A conflict of interest on the part of the trustee was condemned by Mr. Justice Van Devanter, who as a Circuit Judge, stated:

" * * * the trustee's action (in not contesting a claim) was accorded undue consideration, when it is considered that * * * he was represented and presumably advised by counsel who was also representing the creditor whose claim was challenged. Of course, this ought not to have been, no matter what may have been the belief of counsel respecting its propriety. The interests of the creditor were adverse to the bankrupt estate, with the protection of which the trustee was charged, and were in conflict with the interests of others who were represented by the trustee." *In re Stern*, 144 Fed. 956, 959 (C. C. A. 8th, 1906).

This principle applies no less to the instant case. It was not observed by the present Court of Appeals for the Eighth Circuit.

The lack of an independent NOTM Trustee was especially harmful since the MOP Claim involved parent-subsidiary transactions, which have been held by this Court to be "presumptively fraudulent" and to require vigorous judicial scrutiny before allowance.

Corsicana National Bank v. Johnson, 251 U. S. 68, 90 (1919);

Pepper v. Litton, 308 U. S. 295, 306 (1939);

Consolidated Rock Products v. DuBois, 312 U. S. 510, 522-23 (1941).

The type of scrutiny required has been indicated by a decision of the Circuit Court of Appeals for the Fourth Circuit. That Court directed a Trustee to make a further investigation although one had already been made and the District Court had concluded that another would be futile.

In re Central States Electric Corp., 143 F. (2d) 684 (C. C. A. 4th, 1944).

The Court insisted upon:

" . . . an investigation of the most complete and thorough-going character, with opportunity to examine under oath those who had knowledge of the corporation's affairs . . . to the end that all the processes of discovery provided by law might be fully used" (143 F. [2d] at 686).

The common Trustee in the case at bar indicated in the District Court that he did not feel the MOP Claim was especially important; he testified that he always thought that the Claim was "washed out in the Plan, and would be washed out in any Plan" (R. 645). Accordingly, he did not announce whether or not he regarded the MOP Claim as valid until some time after the hearings had commenced in the District Court (R. 646). Previously during the hearings, the Trustee's counsel, who had served in that capacity for many years, was unable to tell the Court the Trustee's attitude on the Claim (R. 392-3).

The failure of the NOTM Trustee to oppose the MOP Claim has not been offset by the efforts of petitioner and other public bondholders. Resources available to a trustee for the purpose of investigation obviously are superior to those at the command of scattered public investors. As the accountant for petitioner testified:

"Mr. Thompson directed me to . . . Mr. Vollmer* (who) . . . stated that they would make records available, but I was not to ask any questions of any of the employees; . . . any direct questioning would have to be done in court" (R. 495).

This is far from the "opportunity to examine under oath" and the full use of "all the processes of discovery provided by law" stressed in the *Central States Electric* case.

* Mr. Vollmer was Executive Assistant to the Trustee (Ex. 56, R. 406).

To permit the validity of the Claim of MOP, a fiduciary, to be established in such circumstances, is to deny to NOTM the protection to which it is entitled.

POINT VI

The opinion of the Circuit Court of Appeals fails to deal with basic questions of law presented by undisputed facts.

The opinion of the Circuit Court of Appeals for the Eighth Circuit does not discuss the *Commonwealth* case, which had been argued before it, although the facts and issues in the *Commonwealth* case are strikingly identical with those in the case at bar. The opinion hardly discusses the other questions of law presented by this case.

The Circuit Court stated that it would not re-examine the facts, and reached its conclusion in reliance on the findings of fact of the District Court.

Petitioner seeks no re-examination of the facts. To a remarkable extent the facts, arising almost entirely from books of account and corporate records, are undisputed.

Thus, when a parent asserts a claim for \$2,795,000 representing sums which the parent, in eleven out of thirteen consecutive quarters, advanced to its dominated subsidiary one day and of which all but \$141,000 was returned to the parent in the next few days in matching payments described as dividends, the question arises whether the parent has a claim for \$141,000 or for \$2,795,000 or any claim at all.

Similarly, it is not disputed that \$1,261,009 of the MOP Claim is based on bookkeeping entries, which MOP, shortly before bankruptcy, unilaterally wrote into the books. MOP increased NOTM's open account by \$1,261,009 and, as consideration, allegedly arranged for the assignment to NOTM of uncollectible claims in the same amount. It is undisputed that the NOTM Board of Directors never

requested, consented to or ratified this transaction. No conceivable benefit could have accrued to NOTM by reason of this unjustifiable imposition by MOP.

There is no dispute about these facts. The only question is one of law. The Circuit Court of Appeals does not discuss this question of law. It is content to rely generally on a finding of good faith. We submit, however, that good faith is insufficient to transform such transactions into a valid and prior claim.

These two items alone comprise a substantial part of the MOP Claim.

Most of the balance of the Claim arises from sums advanced by a parent to its dominated subsidiary to enable it to finance an expansion program, when the subsidiary, in need of funds, was unable to borrow from the public, and was already borrowing from the parent to pay dividends in excess of earnings and for other purposes. This presents a question of law. May a parent by the facile device of denominating such sums as "advances", rather than as additional capital investments, insert a claim against its dominated subsidiary ahead of the claim of public investors?

In the *Deep Rock* case, this Court concerned itself with the question whether, on the facts before it, a District Court had abused its discretion in approving a compromise of a claim, which consisted of advances concededly for the benefit of the subsidiary.

In this case, petitioner does not ask examination of any question of discretion, or of fact.

Petitioner asks solely whether, as a matter of law, the decision on undisputed facts of the Court below, in conflict with the decisions of this Court, the Circuit Court of Appeals for the Seventh Circuit, and of the S. E. C., can stand.

Petitioner urges this Court to take jurisdiction and to determine these questions of law. The reorganization will not be delayed.

CONCLUSION

It is respectfully submitted that a writ of certiorari should be granted.

WILLIAM H. BIGGS,
Attorney for Petitioner,
Security Building,
St. Louis 2, Missouri.

PHILLIP I. BLUMBERG,
of Counsel.